

Letter of Findings Number: 04-20110130
Sales/Use Tax
For Tax Year 2008

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ISSUES

I. Sales/Use Tax—Equipment.

Authority: IC § 6-8.1-5-1(c); IC § 6-2.5-3-2(a); IC § 6-2.5-3-4; IC § 6-2.5-5-2; IC § 6-2.5-5-3(b); IC § 6-2.5-5-5.1(b); [45 IAC 2.2-5-1\(a\)](#); [45 IAC 2.2-5-4\(a\)](#); [45 IAC 2.2-5-8\(c\)](#); [45 IAC 2.2-5-8\(d\)](#); Sales Tax Information Bulletin 9 (August 2008); Letter of Findings 04-20100113 (September 21, 2010).

Taxpayer protests the imposition of use tax on a skidder.

II. Tax Administration—Negligence Penalty and Interest.

Authority: IC § 6-8.1-10-1(e); IC § 6-8.1-10-2.1; [45 IAC 15-11-2\(b\),\(c\)](#).

Taxpayer protests the imposition of a ten percent negligence penalty and the assessment of interest.

STATEMENT OF FACTS

Taxpayer states that he is in the timber harvesting business. Taxpayer purchased a "skidder" tax exempt. The Department issued a proposed assessment for use tax on the skidder (interest and a ten percent negligence penalty were also assessed). Taxpayer filed a protest. An administrative telephone hearing was conducted and this Letter of Findings results. Further facts will be supplied as required below.

I. Sales/Use Tax—Equipment.

DISCUSSION

The Department initially notes that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made, as provided by IC § 6-8.1-5-1(c). Indiana imposes "an excise tax, known as the use tax," on tangible personal property that is acquired in retail transactions and is stored, used, or consumed in Indiana. IC § 6-2.5-3-2(a). An exemption from the use tax is granted for transactions when sales tax was paid at the time of purchase pursuant to IC § 6-2.5-3-4. Since Taxpayer failed to pay sales tax at the time of the purchase, the Department found that the purchase was subject to use tax.

In its protest letter, Taxpayer states that "[T]axpayer purchased the [] Skidder to be used directly in the harvesting of an agricultural commodity—timber." Taxpayer also states in other correspondence to the Department:

I am in the business as a timber buyer and log producer. I buy standing trees and harvest the timber by using chain saws and log skidders to remove the trees from the woods to the fields. My skidder is considered tax exempt.

Taxpayer maintains that as a harvester of timber that the skidder is tax exempt. Taxpayer describes its process as follows. Taxpayer purchases standing timber from landowners. Taxpayer, or someone Taxpayer will hire, then cuts the trees. The skidder drags the cut trees out of the wooded area to a field so that the tree can be cut into different sections (the trees are cut by Taxpayer or a cutter that Taxpayer hires). Later the sections are bid on/sold to a saw mill.

As noted above, Taxpayer argues that it is harvesting an "agricultural commodity—timber." For Indiana tax purposes, Taxpayer is not engaged in agricultural production. As IC § 6-2.5-5-2 states:

(a) Transactions involving agricultural machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for his direct use in the direct production, extraction, harvesting, or processing of agricultural commodities.

(b) Transactions involving agricultural machinery or equipment are exempt from the state gross retail tax if:

(1) the person acquiring the property acquires it for use in conjunction with the production of food and food ingredients or commodities for sale;

(2) the person acquiring the property is occupationally engaged in the production of food or commodities which he sells for human or animal consumption or uses for further food and food ingredients or commodity production; and

(3) the machinery or equipment is designed for use in gathering, moving, or spreading animal waste.

[45 IAC 2.2-5-1\(a\)](#) also states in relevant part, "'Farming' means engaging in the commercial production of food or agricultural commodities as a farmer[.]" and [45 IAC 2.2-5-4\(a\)](#) states, "Agricultural exemption certificates may be used only if the purchaser is occupationally engaged in the business of producing food or commodities for human, animal, or poultry consumption for sale or for further use in such production." (Emphasis added).

Taxpayer's skidder thus does not come within the scope of agricultural production.

The Department next examines the relevant statutes and regulations relating to the manufacturing

exemptions. IC § 6-2.5-5-3(b) states:

(b) Except as provided in subsection (c), transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property.

And [45 IAC 2.2-5-8](#)(c) states:

The state gross retail tax does not apply to purchases of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the article being produced. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property.

Further, pre-production and post production activities are excluded from the exemption in [45 IAC 2.2-5-8](#)(d), which states that:

"Direct use in the production process" begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the production has altered the item to its completed form, including packaging, if required.

Among the documentation submitted by Taxpayer was Sales Tax Information Bulletin 9 (August 2008), 20080827 Ind. Reg. 045080655NRA. That Information Bulletin deals with agricultural production exemptions, and as the analysis above has shown, Taxpayer is not engaged in agricultural production. Among the statutes referenced in Sales Tax Information Bulletin 9 is IC § 6-2.5-5-1. That statute at first glance seems potentially applicable to Taxpayer's business. IC § 6-2.5-5-1(b) states:

Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for direct consumption as a material to be consumed in the direct production of other tangible personal property in the person's business of manufacturing, processing, refining, repairing, mining, agriculture, horticulture, floriculture, or arboriculture. This exemption includes transactions involving acquisitions of tangible personal property used in commercial printing.
(Emphasis added).

However, IC § 6-2.5-5-1(b) requires "direct consumption as a material to be consumed in the direct production...." Taxpayer's skidder is not consumed in the direct production, thus the statute is not applicable to Taxpayer's facts.

As noted, Taxpayer bought trees. Sometimes Taxpayer cut the trees down itself, and at other times Taxpayer hired someone to cut the trees down. After the trees were cut down, Taxpayer would then drag the trees from the woods with a skidder to a field so that the tree could then be cut into sections. Taxpayer, or someone Taxpayer hires, cuts the tree into sections. The sections are then sold to a saw mill. The Department finds that the skidder is moving a raw material, prior to production (See the "Example" provided in [45 IAC 2.2-5-8](#)(d), which states in relevant part that: "Equipment used to transport raw materials to the manufacturing plant is employed prior to the first operation or activity constituting part of the integrated production process and is taxable."). The Department has recently addressed similar facts in Letter of Findings 04-20100113 (September 21, 2010), 20101124 Ind. Reg. 045100697NRA. In that Letter of Findings, the Department stated that the "dragging of the cut trees out of the forest constitutes the movement of raw materials prior to the production process." Thus Taxpayer's skidder is also moving a raw material—and if there is manufacturing production by Taxpayer, that production does not start until after the dragging of the trees.

FINDING

Taxpayer's protest is respectfully denied.

II. Tax Administration—Negligence Penalty and Interest.

DISCUSSION

Taxpayer was also assessed a ten percent negligence penalty. Taxpayer was also assessed interest. Regarding interest, the Department notes that under IC § 6-8.1-10-1(e), that interest cannot be waived.

Penalty waiver, however, is permitted if the taxpayer shows that the failure to pay the full amount of the tax was due to reasonable cause and not due to willful neglect. IC § 6-8.1-10-2.1. The Indiana Administrative Code, [45 IAC 15-11-2](#) further provides in relevant part:

(b) "Negligence" on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

(c) The department shall waive the negligence penalty imposed under [IC 6-8.1-10-1](#) if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish

reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:

- (1) the nature of the tax involved;
- (2) judicial precedents set by Indiana courts;
- (3) judicial precedents established in jurisdictions outside Indiana;
- (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;
- (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

As noted above, reasonable cause regarding penalty is a "fact sensitive question." The Department finds that Taxpayer's failure to pay the sales tax was due to reasonable cause as required by [45 IAC 15-11-2\(c\)](#). While Taxpayer's current circumstances show that Taxpayer acted with reasonable cause, Taxpayer is on notice that penalty waiver might not be warranted should these circumstances arise again in the future.

FINDING

Taxpayer's protest of the penalty is sustained; Taxpayer's protest of the interest is respectfully denied.

SUMMARY

Taxpayer's protest of tax assessed on the skidder is respectfully denied. Taxpayer's protest of the penalty is sustained; Taxpayer's protest of the interest is respectfully denied.

Posted: 12/28/2011 by Legislative Services Agency

An [html](#) version of this document.